

## Message Text

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EUR - MR. ARMITAGE (DRAFT)

E-RMPOATS (DRAFT)

S/S -O: JHOGANSON

C-WSHINN (DRAFT)

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NODIS

E.O. 11652: GDS

TAGS:ENRG, EEWT, UR, US

SUBJECT:US/SOVIET OIL NEGOTIATIONS - FIRST WEEK

1. BASIC DIFFERENCES BETWEEN THE US AND SOVIET POSITIONS  
EMERGED CLEARLY IN THE FIRST WEEK OF THE OIL NEGOTIATIONS.  
AT THE END OF THE WEEK, THE SOVIETS SHOWED SIGNS OF ACCEPT-  
INGTHAT  
THE AGREEMENT SHOULD INCLUDE SOME TYPE OF PRICING FORMULA.  
HOWEVER, THEY REJECTED THE SPECIFIC FORMULA WE PROPOSED.  
THE ATMOSPHERE IN THE FIRST WEEK HAS BEEN BUSINESSLIKE AND  
CORDIAL.

2. AT THE OUTSET, THE SOVIETS INSISTED THAT THEY WANTED  
A BRIEF, GENERAL AGREEMENT THAT WOULD HAVE SIMPLY COMMITTED  
THEM TO OFFER TEN MILLION TONS OF CRUDE AND PETROLEUM  
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PRODUCTS EACH YEAR. THIS WOULD HAVE LEFT IT UP TO THE

SOVIET FOREIGN TRADE ORGANIZATION ON THE ONE HAND, AND THE USG AND/OR COMMERCIAL FIRMS ON THE OTHER TO WORK OUT THE TERMS OF SALE IN SPECIFIC CONTRACTS. THE DRAFT AGREEMENT STATED THAT CRUDE OIL AND PRODUCTS SHOULD BE SOLD AT QUOTE WORLD MARKET UNQUOTE PRICES. THE SOVIETS SAY THEY CANNOT ACCORD ANY PRICE CONCESSIONS IN THE AGREEMENT, BECAUSE THESE WOULD DAMAGE THEIR RELATIONS WITH THIRD COUNTRIES.

3. UNDER SECRETARY ROBINSON MADE IT CLEAR THAT THE TERMS OF SALE MUST BE SUCH THAT US PURCHASERS WILL HAVE AN INCENTIVE TO SWITCH TO NEW SOURCES. THE AGREEMENT MUST THEREFORE INCLUDE A PRICE FORMULA THAT WILL ACCOMPLISH THIS OBJECTIVE. THE SOVIET DRAFT, ROBINSON SAID, WOULD SIMPLY GIVE THE US WHAT WE AND OTHERS ALREADY HAVE. IT WOULD BE INTERPRETED AS A QUOTE NON-AGREEMENT.UNQUOTE

4. THESE GENERAL POSITIONS WERE AIRED IN PLENARY SESSIONS CHAIRED BY ROBINSON AND DEPUTY MINISTER OSIPOV ON JANUARY 26 AND 27. A WORKING GROUP (CHAIRED BY ROBINSON'S SENIOR ADVISOR, RUTHERFORD M. POATS AND SOYUZNEFTE EXPORT PRESIDENT MERKULOV) WAS THEN ESTABLISHED TO GO OVER THE SOVIET DRAFT AND A REVISED US DRAFT (SUBMITTED JANUARY 26) IN DETAIL.

5. THE REVISED US DRAFT DIFFERED FROM THE ONE CONVEYED TO THE SOVIETS LAST NOVEMBER IN THREE WAYS: IT CONVERTED THE TERMS OF SALE FROM AN FOB TO A C AND F BASIS; IT PROVIDED THAT THE CRUDE OIL AND PRODUCTS WILL BE DELIVERED TO THE US (DROPPING THE OPTION OF SWAPS INTO EUROPE); AND IT GAVE US BUYERS THE OPTION TO SUBSTITUTE CRUDE FOR PRODUCTS, INSTEAD OF HAVING TO CONFORM TO THE RATIO OF 70 PERCENT CRUDE/30 PERCENT PRODUCTS CONTAINED IN THE LETTER OF INTENT.

6. IN THE WORKING GROUP, THE US SIDE PROPOSED A FORMULA THAT WOULD SET A C AND F BASE PRICE FOR SOVIET OIL DELIVERED TO GULF AND EAST COAST PORTS AT THE SAME LEVEL AS LOWEST-COST ARABIAN LIGHT CRUDE DELIVERED IN CARIBBEAN PORTS. POATS SAID THAT THIS PRICE IS CURRENTLY \$11.60-11.65 A BARREL. THIS BASE PRICE WOULD BE CONFIDENTIAL

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ADJUSTED, NO MORE FREQUENTLY THAN QUARTERLY, IN ACCORDANCE WITH INCREASES OR DECREASES IN PREVAILING PRICES OF ARABIAN LIGHT CRUDE. POATS SAID WE WERE PREPARED TO CONSIDER OTHER FORMULAS, AS LONG AS THEY ACCOMPLISHED THE SAME AIM OF EFFECTIVE PENETRATION OF THE US MARKET. MERKULOV TOOK CAREFUL NOTE OF THE US PROPOSAL, BUT SHOWED NO SIGN OF DEVIATING FROM HIS POSITION THAT PRICE WAS A MATTER TO BE WORKED OUT BY THE PARTIES TO INDIVIDUAL

TRANSACTIONS.

7. ON SHIPPING, THE SOVIET DRAFT STATED IN GENERAL TERMS THAT THE QUOTE PROVISIONS OF THE SOVIET-AMERICAN MARITIME AGREEMENT WILL BE APPLIED. UNQUOTE. THE US SIDE SAID IT WANTED TO ESTABLISH A MORE SPECIFIC UNDERSTANDING TO APPLY THE CONTROLLED CARGO PROVISIONS OF THE MARITIME AGREEMENT

TO THE OIL SHIPMENTS, IN ORDER TO ENSURE THE PARTICIPATION OF US FLAG VESSELS. WE PROPOSED THAT BLACKWELL AND AVERIN MEET TO WORK OUT THE CONDITIONS OF CARRIAGE BEFORE THE OIL AGREEMENT IS SIGNED, AND SAID THAT BLACKWELL IS PREPARED TO INVITE AVERIN TO COME TO WASHINGTON NOW FOR THIS PURPOSE.

8. A NUMBER OF OTHER POINTS OF DISAGREEMENT EMERGED FROM THE WORKING GROUP DISCUSSIONS, INCLUDING WHAT THE AGREEMENT SHOULD BE CALLED, ITS STARTING DATE, THE DESIRABILITY OF INCLUDING LANGUAGE ON ARBITRATION, WHETHER TO SET PRICES FOR PETROLEUM PRODUCTS, AND HOW TO HANDLE CASES IN WHICH MORE OR LESS THAN THE 10 MILLION TONS ARE SOLD IN ANY GIVEN YEAR. IN ADDITION, THE SOVIETS BELIEVE THAT THE CRUDE AND PRODUCTS SHIPPED UNDER THE AGREEMENT SHOULD BE MADE AVAILABLE TO ALL US COMPANIES, WHEREAS THE US WANTS TO RESERVE THE RIGHT TO DESIGNATE CERTAIN BUYERS (FOR EXAMPLE, INDEPENDENT REFINERS WHO DO NOT HAVE ACCESS TO LOW-COST PERSIAN GULF CRUDE). THE SOVIETS ALSO MAINTAIN THAT THE TWO GOVERNMENTS SHOULD DECIDE WHETHER THERE CAN BE DEVIATIONS FROM THE 70/30 PERCENT RATIO BETWEEN CRUDE AND PRODUCTS.

9. AT THE END OF THE WEEK, IN AN EFFORT TO MEET THE SOVIET DESIRE FOR A SIMPLER AGREEMENT, THE US SIDE TABLED A NEW CONFIDENTIAL

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DRAFT, ELIMINATING SOME OF THE TECHNICAL DETAILS WHICH COULD BE LEFT TO COMMERCIAL CONTRACTS, AND RELEGATING OTHERS (PRICE, PRODUCT SPECIFICATIONS) TO ANNEXES. ON FRIDAY AFTERNOON, THE SOVIETS MADE PRELIMINARY COMMENTS ON THIS NEW DRAFT, WHICH WILL BE DISCUSSED FURTHER ON MONDAY. MERKULOV SEEMED PREPARED, AT THIS STAGE, TO ACCEPT THE PRINCIPLE OF INCLUDING AN ANNEX WITH A PRICING FORMULA IN THE AGREEMENT. HOWEVER, HE OBJECTED TO BOTH OUR BASE C AND F PRICE LEVEL AND THE LACK OF PROTECTION FOR THE USSR AGAINST SHIPPING PRICE INCREASES

10. TOWARD THE END OF FRIDAY'S SESSION, POATS SUMMARIZED WHERE THINGS STOOD BY SAYING THAT THE FIRST WEEK HAD BEEN ONE OF CLARIFICATION, WHEREAS NEXT WEEK IS FOR SERIOUS NEGOTIATIONS, WITH A VIEW TO REACHING AGREEMENT.

11. COPIES OF THE SOVIET AND REVISED US DRAFTS ARE BEING  
POUCHED. KISSINGER

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